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In The

# Supreme Court of the United States

October Term, 1996

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Commissioner of Internal Revenue,
*Petitioner*,
v.

Estate of Otis C. Hubert, Deceased,
C & S Sovran Trust Company (Georgia) N.A.,
A National Banking Association, Co-Executor,
*Respondent*.

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On Writ of Certiorari to the
United States Court of Appeals
for the Eleventh Circuit

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## BRIEF *AMICI CURIAE* OF THE AMERICAN COUNCIL ON EDUCATION AND UNITED WAY OF AMERICA IN SUPPORT OF RESPONDENT

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# Supreme Court of the United States

OCTOBER TERM, 1996

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No. 95-1402

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COMMISSIONER OF INTERNAL REVENUE,
*Petitioner*,

v.

ESTATE OF OTIS C. HUBERT, DECEASED,
C & S SOVERAN TRUST COMPANY (GEORGIA) N.A.,
A NATIONAL BANKING ASSOCIATION, CO-EXECUTOR,
*Respondent*.

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**On Writ of Certiorari to the
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## BRIEF *AMICI CURIAE* OF THE AMERICAN COUNCIL ON EDUCATION AND UNITED WAY OF AMERICA IN SUPPORT OF RESPONDENT

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This brief in support of respondent is submitted with the written consent of counsel for respondent and the Solicitor General filed with the Clerk of the Court.

### INTEREST OF THE *AMICI CURIAE*

The American Council on Education ("ACE") is a voluntary membership organization comprised of more than 1,800 institutions of higher education from both the

public and private sectors and more than 175 nonprofit educational associations and organizations.

United Way of America is a national service and training center that provides training, resources and support to approximately 1,400 local United Way members. These member United Way organizations raised $3.184 billion in 1995 which supported approximately 45,000 health and human service organizations ranging from disaster relief, emergency food and shelter, job training and crisis intervention to day care, physical rehabilitation and youth development. Apart from government, United Ways support the greatest variety of health and human services in the country.

ACE and United Way of America and their respective members and affiliates are charitable organizations described in Section 501(c)(3) of the Internal Revenue Code. Testamentary charitable contributions constitute a major source of support for ACE. Likewise, testamentary giving contributes to the overall charitable dollars received by United Way of America and its members. Accordingly, any limitation on the charitable deduction is of great concern to these organizations. ACE and United Way of America submit this brief *amici curiae* to assist the Court, first, in appreciating that charitable contributions will be significantly reduced if the decision below is reversed and, second, in ascertaining the proper relationship between state law probate procedures and federal estate taxation.

## SUMMARY OF ARGUMENT

In an effort to encourage charitable giving, federal law allows a charitable deduction for the amount of the gross estate which passes to charity. Thus, to the extent that an amount was included in the gross estate reported on the federal estate tax return and actually distributed to the charity, the estate should be allowed a deduction. The



government contends, however, that the charitable deduction must be reduced by estate administration expenses even when those expenses have been properly paid from amounts not included in the gross estate. This position is not supported by the statutory language or by congressional intent. Moreover, in the case of a residuary charitable bequest, the charitable deduction would be reduced not only by the amount of the administration expenses, but also by the additional estate tax generated as a result of the reduced deduction. The resulting "multiplier" effect will have a severe adverse impact on charitable bequests.

In its brief, the government contends that the amount of the charitable deduction should not depend on how the executor has allocated administration expenses or on the particular state law governing such allocations. Rather, the government seeks to impose a uniform federal rule requiring a reduction in the charitable deduction for all administration expenses, regardless of the source of their payment. The government's approach misconstrues the proper relationship between the federal law imposing the estate tax and state law which defines the interests upon which the estate tax acts. The amount of the residuary estate which a charity will actually receive is a matter for factual determination based on state law and proper probate procedures, not on fiction or an absolute and arbitrary federal rule. In addition, the maritai deduction regulation upon which the government heavily relies does not in fact require a reduction in the marital or charitable deduction as the government asserts. Rather, the relevant regulations, as well as a venerable revenue ruling issued by the Internal Revenue Service, support the conclusion that a proper allocation of administration expenses to estate income should not necessitate a reduction or diminution of the charitable or marital deduction, provided that the allocation is made solely in a fiduciary capacity in accordance with the general standards of trust administration prescribed by applicable state law.

## ARGUMENT

### I. THE GOVERNMENT'S POSITION WOULD DEPRIVE ESTATES AND THEIR CHARITABLE BENEFICIARIES OF THE FULL BENEFIT OF THE FEDERAL ESTATE TAX DEDUCTION FOR AMOUNTS DISTRIBUTED TO CHARITY

#### A. Reducing The Charitable Deduction By Administration Expenses Properly Charged To Income Would Undermine Congressional Intent

Congress intentionally accorded charitable bequests special estate tax benefits under the Internal Revenue Code (the "Code"). Specifically, Section 2055(a) of the Code allows a deduction "from the value of the gross estate" for the amount of "all bequests, legacies, devises, or transfers" to charity. I.R.C. § 2055(a). A decedent's gross estate consists of the value on the date of death (or on the alternate valuation date) of all of a decedent's property. I.R.C. § 2031(a). Only property included in the decedent's gross estate may qualify for the charitable deduction. I.R.C. § 2055(d); 26 C.F.R. § 20.2055-1(a) (1995). Income received by the estate during its administration is not included in the gross estate. Thus, even if estate income is properly paid to the charitable beneficiary under state law, no additional estate tax deduction is allowed. By the same token, to the extent that administration expenses are properly paid from post-mortem income under state law, the amount of the gross estate actually passing to the charitable beneficiary is not reduced.

Nevertheless, through a series of strained arguments at odds with the realities of estate administration, the government contends that, where estate administration expenses are properly paid from estate income, the estate and charitable beneficiary should not receive the benefit of the full charitable deduction for the amount of the gross estate actually passing to the charity. As the courts below held, however, just as the estate should not receive



a charitable deduction for more of the gross estate than actually passes to charity,[1] so should it not receive a lesser deduction. To hold otherwise would contravene the language of the statute which directs that there be deducted "from the value of the gross estate the amount of all bequests, legacies, devises, or transfers" to charity. I.R.C. § 2055(a).

Moreover, such an unwarranted reduction in the amount passing to charity is in direct conflict with Congress's express intent to foster charitable giving. As this Court itself has recognized, in enacting the charitable deduction provisions in Section 2055 and its predecessors, Congress sought to encourage gifts to charity. *Commissioner v. Estate of Sternberger*, 348 U.S. 187, 190 n.3 (1955); *YMCA v. Davis*, 264 U.S. 47, 50 (1924). Indeed, it is now well settled that the "congressional intent to prefer charitable gifts to estate taxes was 'a case of absolute priority . . . [and that] [While] loopholes should not be permitted to diminish estate tax payments by ostensibly charitable bequests which may never become effective,' [the courts] cannot blindly resolve all doubts in favor of the IRS if [they] are to respect legislative intent to encourage gifts to charity." *Flanagan v. United States*, 810 F.2d 930, 934-35 (10th Cir. 1987) (quoting *Norris v. Commissioner*, 134 F.2d 796, 801 (7th Cir.), *cert. denied*, 320 U.S. 756 (1943)). As illustrated by the examples discussed below, the government's position in this case would frustrate Congress's intent to encourage charitable bequests.

#### B. The Government's Position Would Severely And Adversely Impact Charitable Beneficiaries

The government's position would require that the amount of the charitable deduction be reduced by the

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[1] *See also Harrison v. Northern Trust Co.*, 317 U.S. 476, 480 (1943) (estate is entitled to deduct only the amount actually passing to the charitable beneficiary).

amount of the estate's administration expenses even when such expenses were properly charged to post-mortem income not includible in the gross estate. The two short examples which follow illustrate the harsh effects of the government's position on charitable beneficiaries.

Assume, for example, that a decedent had a gross estate of $10,000,000. His will bequeathed $600,000 (the amount protected from federal estate tax by reason of the unified credit allowed by Section 2010) to his family and left his residuary estate to charity. The will directed that all taxes, debts and administration expenses be paid from the residuary estate. Assume further that the estate incurred $500,000 of administration expenses, $200,000 of which were properly paid from estate income and deducted on the estate's fiduciary income tax return,[2] and $300,000 of which were paid from estate corpus and deducted on the federal estate tax return. Based on the foregoing facts, the amount of the *gross estate* actually passing to charity is $9,100,000 ($10 million reduced by the $600,000 bequest and expenses of $300,000 paid from the corpus included in the gross estate).[3] The federal estate tax imposed on the estate will therefore be zero. If, however, as the government contends, the charitable deduction must also be reduced by the expenses properly paid from estate income, the charitable deduction will be reduced not only by the additional $200,000 of administration expenses, but also by the estate tax generated as

[2] Section 2053 of the Code allows estate administration expenses to be deducted from the gross estate. Section 642(g), however, authorizes executors to elect to deduct such expenses on the estate's fiduciary income tax returns or on the estate tax return.

[3] As the government noted in its brief (Petitioner's Brief at 19), it is not disputed that, to the extent that administration expenses are paid directly from the corpus of the residuary estate passing to charity, the charitable deduction must be commensurately reduced.



a result of the lower deduction.[4] As a consequence, even though the charity should actually have received an amount of the gross estate equal to $9,100,000, a charitable deduction of only $8,777,049 will be allowed. As a result, the estate's estate tax liability will increase from zero to $122,951 or 61.47% of the $200,000 of administration expenses paid from income. This $122,951 will pass to the government, rather than to the charity.

The severity of the impact on the charitable beneficiary is even more starkly illustrated in the case of a larger taxable estate. Assume, for example, that all of the above facts remain the same except that the decedent's will leaves $3,000,000 to his family, rather than only $600,000.[5] If the estate is allowed a charitable deduction for the actual amount of the gross estate passing to the charity, the federal estate tax liability will be $2,439,999. If, however, the charitable deduction is reduced for the administration expenses properly paid from estate income, the estate's tax liability will increase by $244,445 or 122%

[4] Any reduction in the charitable deduction will increase the amount of estate tax owed, which will further decrease the charitable deduction, which will increase the amount of estate tax owed, and so on. The resulting interrelated computation or "multiplier" effect will cause the amount of additional estate tax owed as a result of the initial reduction in the charitable deduction to far exceed the amount which would be owed if the estate's marginal estate tax rate were simply applied to the amount of the reduction.

[5] In larger estates, it is not uncommon for a decedent to provide for his family through lifetime gifts or pre-residuary bequests and then to leave his residuary estate to charity. Alternatively, he may divide his residuary estate between his family and charity or utilize residuary split-interest trusts. In all of these situations, the issue presented by this case is potentially determinative of the amount which the charitable beneficiary will receive. Because estates utilizing this type of planning are typically large, residuary charitable bequests represent a significant source of funds for charitable organizations. Thus, although not all charitable bequests are affected by the issue presented here, its significance for the charitable community should not be underestimated.

of the $200,000 of administration expenses paid from income. Thus, as a result of the disallowed deduction for $200,000 of the gross estate which would actually have been distributed to the charity, the charity will receive $244,445 less. This harsh impact was not intended by Congress.

## II. THE GOVERNMENT'S EFFORT TO IMPOSE AN ABSOLUTE FEDERAL RULE IGNORES THE PROPER ROLE OF STATE LAW AND IS NOT SUPPORTED BY THE INTERNAL REVENUE SERVICE'S OWN REGULATIONS

In its brief, the government contends that the amount of the charitable deduction should not turn on how the executor has allocated the administration expenses or on how state law permits such expenses to be allocated. Rather, the government describes the proper treatment of the allowable administration expenses for estate tax deduction purposes as a "federal question." Petitioner's Brief at 32. Although the interpretation and implementation of the federal estate tax is certainly a federal matter, the government's position would go too far in imposing a federal rule regarding the payment of administration expenses which is at odds with the realities of the administration of decedents' estates, as well as with the Internal Revenue Service's own regulations and revenue rulings.

This Court in *Morgan v. Commissioner*, 309 U.S. 78, 80 (1940), explained the interrelationship between state law and the federal estate tax law as follows:

> State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.

*Id.* at 80. Accordingly, numerous courts have recognized that the proper devolution of property in the estate, the composition of the residuary estate and the identification of the property from which debts, taxes and administration expenses must be paid are all matters to be determined



by state law. *Riggs v. Del Drago*, 317 U.S. 95 (1942).[6] Thus, the federal estate tax acts on the estate after the property rights of the beneficiaries have first been determined in accordance with state law. The federal estate tax thereby accords with and reflects the reality of the estate distribution, rather than creating a fictional distribution intended to generate additional tax revenues.

State property law impacts the imposition of the federal estate tax in many ways. For example, how estate taxes are apportioned among the beneficiaries, and thus whether the marital or charitable deduction will be reduced by such taxes, is clearly a matter determined by state law. *Riggs v. Del Drago*, 317 U.S. at 100-01; *Harrison v. Northern Trust Co.*, 317 U.S. 476. As noted by this Court in *Harrison v. Northern Trust Co.*, 317 U.S. at 479, "the ultimate thrust of the federal estate tax is to be determined by state law."

Similarly, although federal law is determinative of the tax imposed on property subject to a general power of appointment, it is state law that determines to whom property can be appointed and thus whether a power is a general power within the meaning of the federal statute. *Morgan v. Commissioner*, 304 U.S. 78. As this Court has recognized, it is entirely proper that state law control "in determining the nature of the legal interest which the taxpayer had in the property or income sought to be reached by the statute." *Id.* at 82.

It is equally well established that whether an estate expenditure is chargeable to principal or to income is a matter of state law. *Estate of Richardson v. Commis-*

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[6] *See also Harris v. United States*, 370 F.2d 887, 893 (4th Cir. 1966); *Estate of Warren v. Commissioner*, 93 T.C. 694 (1989), *rev'd on other grounds and remanded*, 981 F.2d 776 (5th Cir. 1993); *Estate of Horne v. Commissioner*, 91 T.C. 100 (1988); *Estate of Fine v. Commissioner*, 90 T.C. 1068 (1988), *aff'd mem.*, 885 F.2d 879 (11th Cir. 1989); *Estate of Reid v. Commissioner*, 90 T.C. 304 (1988); *Estate of Short v. Commissioner*, 68 T.C. 184, 190 (1977), *acq.*, 1977-2 C.B. 2.

*sioner*, 89 T.C. 1193 (1987); *Estate of Street v. Commissioner*, 56 T.C.M. (CCH) 774 (1988), *aff'd in part and rev'd in part*, 974 F.2d 723 (6th Cir. 1992). Thus, whether such an expenditure will in fact reduce the amount of the gross estate passing to a charitable beneficiary will properly depend on state law.

The government attempts to override these settled principles in several ways. First, the government asserts that administration expenses must reduce the marital or charitable deduction in all cases, regardless of whether they are paid from principal or income, because they reduce the "real value" or the "net economic interest" received by the surviving spouse or charity. Petitioner's Brief at 27. In seeking to support its position, the government maintains that "[t]he 'value' of property left as a bequest includes, as one of the sticks in the bundle of rights, the right to receive the stream of income derived from that property." *Id.* at 27. Such a contention ignores the fact that the nature of the "bundle of rights" and of its component "sticks" is determined by state law, not federal law. Indeed, state law varies considerably regarding the rights which various beneficiaries have to share in the post-mortem income of an estate.[7]

[7] Virtually all states provide that income earned on property which is specifically bequeathed shall be paid to the beneficiary of such property. Beyond this, however, state law varies considerably. In some states, a proportionate share of the post-death income is paid to the legatee of a pecuniary bequest, but only if the bequest is in trust. *See, e.g.*, Alaska Stat. § 13.38.040(b)(2) (1995); Ariz. Rev. Stat. Ann. § 14-7405(B)(2) (1995); N.Y. Est. Powers & Trusts § 11-2.1(d)(2)(B) (McKinney Supp. 1996). In others, an outright pecuniary bequest will share, but only if the spouse is the beneficiary. *See, e.g.*, 760 I.L.C.S. ch. 15, para. 6(b)(2) (Smith-Hurd 1992); Md. Code Ann., Est. & Trusts § 7-304(b)(2) (1991). In still other states, pecuniary bequests do not share in income regardless of whether they are outright or in trust. *See, e.g.*, Cal. Prob. Code § 12003 (West 1991); Del. Code Ann. tit. 12, § 6105(b)(2) (1995 repl.); N.J. Stat. Ann. § 3B:19A-12(a)(2) (West Supp. 1996). And, finally, in some states, all beneficiaries share proportionately in the post-death income. *See, e.g.*, Tex. [Continued]



Second, the government argues that administration expenses accrue at the date of death, even though the amount of such expenses is not then ascertainable. According to the government, administration expenses are therefore an encumbrance existing as of the moment of death which must reduce the gross estate. Petitioner's Brief at 24. *See also Burke v. United States*, 994 F.2d 1576 (Fed. Cir.), *cert. denied*, 510 U.S. 990 (1993). The government's contention, however, is divorced from the realities of estate administration. Clearly, the amount of the administration expenses and, equally importantly, their nature, can be determined only as the estate administration proceeds and the expenses are in fact incurred.

Finally, for purposes of determining the amount of either a charitable or marital deduction, the government places major reliance on a marital deduction regulation which provides that "[i]n determining the value of the interest in property passing to the spouse account must be taken of the effect of any material limitations upon her right to income from the property." 26 C.F.R. § 20.2056

[7] [Continued]
Prob. Code Ann. § 378B(d) (West Supp. 1996). In addition, many states provide that interest will be paid on pecuniary bequests if they are not paid within a certain period of time after the date of death. *See, e.g.*, Ga. Code Ann. § 53-2-97 (1995); Cal. Prob. Code § 12003 (West 1991); Tex. Prob. Code Ann. § 378B(f) (West Supp. 1996). Again, the time period and rate of interest vary from state to state. For instance, in some states, interest begins to accrue on pecuniary bequests one year after the testator's death. *See, e.g.*, Cal. Prob. Code § 12003 (West 1991); Ga. Code Ann. § 53-2-97 (Michie 1982). In others, interest begins to run one year after the date the personal representative is appointed. *See, e.g.*, Tex. Prob. Code Ann. § 378B(f) (West Supp. 1966). In some states, the rate of interest is based on a formula. *See, e.g.*, Cal. Prob. Code § 12001 (West Supp. 1996) (rate is three percentage points less than the legal rate on judgments in effect one year after the date of the testator's death), while in others, the percentage rate is set by statute. *See, e.g.*, Ga. Code Ann. § 7-4-2 (1989) (applicable rate of interest is seven percent); Tex. Prob. Code Ann. § 378B(f) (West Supp. 1996) (applicable rate of interest is six percent).

(b)-4(a) (1995). The regulation illustrates this general principle with the following example:

> An example of a case in which this rule may be applied is a bequest of property in trust for the benefit of the decedent's spouse but the income from the property from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate.

*Id.* According to the government, this regulation "specifies that the marital deduction *must* be reduced whenever administration expenses have been paid from post-death income, regardless of the exact amount of the expenses in relation to the income." Petitioner's Brief at 31 (emphasis supplied); *see also id.* at 30 n.8. In fact, the Internal Revenue Service's regulations and rulings do not say what the government claims they say and, thus, do not support the absolute rule for which the government contends.

In the first place, the example quoted above does not state, as the government repeatedly asserts, that the rule requiring adjustments for material limitations "*must*" apply if marital income is used to pay administration expenses; rather, the regulation cites payment of administration expenses from marital income as an example of a case in which the rule "*may*" be applicable. Whether the rule applies in a particular case depends on whether, under the general principle of the regulation, the payment of such expenses from income falls within the category of "material limitations" on the right to receive income from the property.

In this regard, the government ignores the fact that the marital deduction statute explicitly states that, for purposes of determining the value of the interest passing to the surviving spouse,

> where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to



> the passing of such interest, such encumbrance or obligation shall be taken into account *in the same manner as if the amount of a gift to such spouse of such interest were being determined.*

I.R.C. § 2056(b)(4)(B) (emphasis supplied). This direction to look to the gift tax regulations is repeated in the very same marital deduction regulation upon which the government relies in its brief.[8]

The relevant gift tax regulations address a spouse's right to income from a marital trust. The regulations state the general rule that a trust will qualify for the marital deduction "if the effect of the trust is to give [the spouse] substantially that degree of beneficial enjoyment of the trust property during [the spouse's] life which the principles of the law of trust accord to a person who is unqualifiedly designated as the life beneficiary of a trust." 26 C.F.R. § 25.2523(e)-1(f)(1) (1995). Thus, for purposes of determining the nature of the property interests to which the estate or gift tax will apply, the regulations again look to state law trust principles. In addition, the regulations specifically provide that "[a]mong the powers which if subject to reasonable limitations will not disqualify the interest transferred in trust are the power to determine the allocation or apportionment of receipts and disbursements between income and corpus. . . ." 26 C.F.R. § 25.2523(e)-1(f)(4) (1995). The regulations thus explicitly reject any hard-and-fast rule regarding allocation of receipts and disbursements in favor of a case-by-case determination that is dependent upon whether the powers granted are subject to "reasonable limitations."[9]

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[8] "The marital deduction may be taken only with respect to the net value of any deductible interest which passed from the decedent to his surviving spouse, *the same principles being applicable as if the amount of a gift to the spouse were being determined.*" 26 C.F.R. § 20.2056(b)-4(a) (1995) (emphasis supplied).

[9] The regulations provide that:

> In the case of a trust, the rules to be applied by the trustee in allocation of receipts and expenses between income and corpus

How then can the totality of the statutory language and the regulations be reconciled with the government's absolute position that administration expenses paid from income *must* in all cases reduce the marital and/or charitable deduction? In the view of the *amici curiae*, it cannot. Rather, we believe that the approach adopted by the Internal Revenue Service more than a quarter-century ago in Revenue Ruling 69-56, 1969-1 C.B. 224, represents the correct approach in resolving this issue.

In Revenue Ruling 69-56, the Internal Revenue Service provided examples of fiduciary powers that do not constitute "material limitations" on a spouse's right to receive income from a marital trust.[10] In the first example, the

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must be considered in relation to the nature and expected productivity of the assets transferred in trust, the nature and frequency of occurrence of the expected receipts, and any provisions as to change in the form of investments. If it is evident from the nature of the trust assets and the rules provided for management of the trust that the allocation to income of such receipts as rents, ordinary cash dividends and interest will give to the spouse the substantial enjoyment during life required by the statute, provisions that such receipts as stock dividends and proceeds from the conversion of trust assets shall be treated as corpus will not disqualify the interest transferred in trust. Similarly, provision for a depletion charge against income in the case of trust assets which are subject to depletion will not disqualify the interest transferred in trust, unless the effect is to deprive the spouse of the requisite beneficial enjoyment. The same principle is applicable in the case of depreciation, *trustees' commissions, and other charges.*

26 C.F.R. § 25.2523(e)-1(f)(3) (1995) (emphasis supplied).

[10] In its brief, the government in a footnote attempts to dismiss Revenue Ruling 69-56, stating that the ruling "expressly addressed only whether 'the *inclusion of such powers* or directions *in the governing instrument* * * * [would] result in the disallowance or diminution of the marital deduction.' . . . It did not, as the Tax Court implied, address whether the actual payment of such administration expenses out of corpus or income of the marital bequest would require a reduction in the marital deduction." Petitioner's Brief at 30 n.8. This facile distinction ignores the ruling's true



governing instrument confers upon the fiduciary a power "[t]o charge to income or principal, executor's or trustee's commissions, legal and accounting fees, custodian fees, and similar administration expenses." Rev. Rul. 69-56, 1969-1 C.B. 224 (Ex. 1). In the second example, the governing instrument confers upon the fiduciary a general power to determine the manner in which receipts and expenses will be allocated between income and principal. The example stipulates further that "[u]nder applicable State law the fiduciary's determination must be made so as to balance fairly the interests of [the income beneficiary and the remainderman]." *Id.* The ruling concludes that "the grant of such power in and of itself does not evidence the intention to deprive the surviving spouse of the beneficial enjoyment required by the statute, and does not result in the disallowance or diminution of the marital deduction." *Id.* at 225. In reaching this conclusion, the Service relies upon the fact that

> applicable State law requires that the fiduciary's determination must be made so as to balance fairly the interests of the income beneficiary and the remainderman. . . . [T]he applicable State law illustrates the general limitation imposed by the law of trusts upon the exercise of such a power, namely, that all exercises of discretion by the fiduciary are to be made solely in a fiduciary capacity in accordance with the general standards of trust administration imposed upon fiduciaries.

*Id.* at 224. Thus, rather than adopting an absolute rule such as that advocated by the government now, the ruling recognizes that the allocation of expenses to income or

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relevance and meaning. The real concern addressed by the ruling and the regulations is not just that particular fiduciary powers may be included in the governing instrument, but that they would be exercised. The clear import of the ruling is that, so long as they are properly exercised in conformity with applicable state law principles governing fiduciary discretion, they will not cause a disallowance or diminution of the marital deduction.

principal *may*, but will not necessarily, constitute a material limitation which must be taken into account in determining the amount of the marital (or charitable) deduction. In order to make this determination, a court must assess the facts of the particular case in the context of the applicable state trust law and the constraints which such law places upon fiduciaries.[11]

In the instant case, Georgia law authorized the allocation of estate administration expenses to income rather than principal, if permitted under the will. The decedent's will granted his executors the power to "charge any expenses against income or principal or apportion the same" and directed the executors to "make any election permitted by any tax law . . . if in the opinion of my Executors . . . such election is for the combined best interest of my Estate and the beneficiaries." From 1986 to 1990, the estate generated over $5,000,000 of income and incurred over $1,400,000 in administration expenses. In a proper exercise of fiduciary discretion, the executors allocated $506,989 of those expenses to principal and the remainder to income. There is no suggestion that this allocation was anything other than a proper exercise of fiduciary discretion which accorded with the general standards imposed upon fiduciaries by state law.

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[11] In a very recent case, *Estate of Sobota v. Commissioner*, 71 T.C.M. (CCH) 3217 (1996) (Tannenwald, J.), the Tax Court applied precisely this analysis. Because under the applicable state law (Wisconsin) the personal representative's fee was required to be charged to principal passing to the decedent's wife, the Tax Court held that the marital deduction must be reduced.



## CONCLUSION

Accordingly, the judgment of the United States Court of Appeals for the Eleventh Circuit should be affirmed.

Respectfully submitted,

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